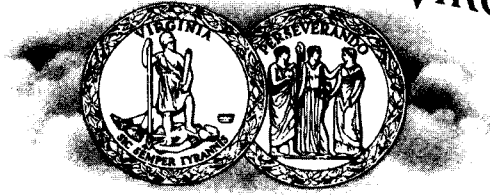


Examination Report
on
FARMERS MUTUAL FIRE INSURANCE COMPANY
OF WASHINGTON COUNTY, VIRGINIA
Abingdon, Virginia
as of
December 31, 2007

COMMONWEALTH OF VIRGINIA

ALFRED W. GROSS
COMMISSIONER OF INSURANCE
STATE CORPORATION COMMISSION
BUREAU OF INSURANCE



P.O. BOX 1157
RICHMOND, VIRGINIA 23218
TELEPHONE: (804) 371-9741
TDD/VOICE: (804) 371-9206
<http://www.scc.virginia.gov/division/boi>

I, Alfred W. Gross, Commissioner of Insurance of the Commonwealth of Virginia, do hereby certify that the annexed copy of the Examination Report of Farmers Mutual Fire Insurance Company of Washington County, Virginia as of December 31, 2007, is a true copy of the original report on file with this Bureau.

IN WITNESS WHEREOF, I have hereunto set my hand
and affixed to the original the seal of the Bureau at the City
of Richmond, Virginia this 14th day of August, 2008

Alfred W. Gross
Commissioner of Insurance

(SEAL)

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Richmond, Virginia
May 16, 2008

Honorable Alfred W. Gross
Commissioner of Insurance
Commonwealth of Virginia
Richmond, Virginia

Dear Sir:

Pursuant to your instructions and by authority of § 38.2-1317 of the Code of Virginia, a financial examination of the records and affairs of the

**FARMERS MUTUAL FIRE INSURANCE COMPANY
OF WASHINGTON COUNTY, VIRGINIA
Abingdon, Virginia**

hereinafter referred to as the Company, has been completed. The report thereon is submitted for your consideration.

DESCRIPTION

The Company is a mutual assessment property and casualty insurer licensed under and subject to Chapter 25 of Title 38.2 of the Code of Virginia. It was last examined by representatives of the State Corporation Commission's Bureau of Insurance (Bureau) as of December 31, 2004. This examination covers the period from January 1, 2005 through December 31, 2007.

HISTORY

The Company was granted a charter on December 13, 1910, which has been amended several times. According to the charter, the purpose for which the Company was formed is as follows:

...to carry on a mutual assessment fire insurance company transacting mutual assessment fire insurance as defined by Section 38.1-659 of the Code of Virginia as amended from time to time.

The most recent amendment, which was made on September 8, 1981, restricted the Company's operations to the four adjacent counties of Russell, Scott, Smyth and Washington and the city of Bristol, Virginia.

MANAGEMENT AND CONTROL

The management of the Company is vested in a board of directors consisting of nine members. As provided in the Company's bylaws, directors are elected by members at their annual meeting to serve for a period of three years. A majority of the directors constitutes a quorum for any meeting of the board. The board of directors elects the officers.

At December 31, 2007, the directors and officers of the Company were as follows:

<u>Directors</u>	<u>Principal Occupation</u>
James C. Atwell	Farmer, Retired Abingdon, Virginia
Robert C. Berry	Farmer Abingdon, Virginia
David R. Fore	Retired Abingdon, Virginia
Michael Countiss	Farmer Abingdon, Virginia
Walter R. McNew	Retired Abingdon, Virginia
James W. Hay	Retired Deputy Sheriff Abingdon, Virginia
W. Blair Keller, Jr.	Retired Abingdon, Virginia
Lawrence T. Lester	Farmer Meadowview, Virginia
Russell T. Smith, Jr.	Farmer Meadowview, Virginia

Officers

James C. Atwell	President
Lawrence T. Lester	Vice President
Nannie T. Groseclose	Secretary-Treasurer

FIDELITY BOND AND OTHER INSURANCE

The Company had a fidelity bond in force at December 31, 2007, providing coverage in the amount of \$100,000, subject to a deductible of \$1,000 per occurrence. The Company also had insurance coverages in force that included workers' compensation, professional liability and directors' and officers' liability, commercial property, commercial general liability, inland marine, and commercial excess liability (umbrella) coverage.

TERRITORY AND PLAN OF OPERATION

The Company limits its operations to the four counties of Russell, Scott, Smyth and Washington and the city of Bristol, Virginia. Business is produced through four licensed agents who are either employees or commissioned agents.

The lines of business written include the following:

- Fire, lightning and windstorm on buildings, mobile homes, personal property and livestock and machinery.
- Extended coverage, plate glass, vandalism, malicious mischief and liability as supplements to the basic policy.
- Homeowners and mobile homeowners with a comprehensive personal liability endorsement or a farmer's comprehensive personal liability endorsement.
- Church package policy.

Property is classified primarily according to location, use, type of construction and availability of fire departments. The board of directors sets classifications and assessment rates. Assessments are levied annually during the month of original issue. The Company adjusts claims utilizing the services of independent claims adjusters.

It is the practice of the Company to retain \$20,000 on property insured, and \$25,000 on bodily injury and property damage liability coverage.

GROWTH OF THE COMPANY

The following data, obtained from the Company's annual statements and examination reports, indicates its growth during the ten-year period ending December 31, 2007:

<u>Year</u>	<u>Net Assessments Received</u>	<u>Investment Income</u>	<u>Net Losses Paid</u>	<u>Number of Policies</u>	<u>Amount of Insurance In Force</u>
1998	\$549,104	\$160,532	\$314,608	6,767	\$314,415,767
1999	541,007	158,455	171,971	6,890	322,354,814
2000	634,326	183,736	266,296	6,703	334,857,829
2001	640,617	195,825	181,604	6,786	347,232,791
2002	659,106	175,384	316,455	6,934	375,084,053
2003	563,255	136,357	178,066	7,290	443,913,160
2004	838,130	159,968	336,479	7,884	533,997,094
2005	999,368	153,493	393,922	7,939	565,884,334
2006	963,642	253,542	380,563	7,909	589,634,509
2007	1,014,428	244,444	282,890	7,759	587,884,341

<u>Year</u>	<u>Ledger Assets</u>	<u>Net Admitted Assets</u>	<u>Liabilities</u>	<u>Surplus</u>
1998	\$2,869,576	\$3,001,384	\$424,847	\$2,576,537
1999	3,075,974	3,223,679	464,701	2,758,978
2000	3,244,109	3,454,135	494,626	2,959,509
2001	3,566,415	3,707,121	541,253	3,165,868
2002	3,650,436	3,721,463	556,878	3,164,585
2003	3,781,539	3,857,603	521,843	3,335,760
2004	4,060,222	4,143,859	630,165	3,513,694
2005	4,321,357	4,426,423	827,906	3,598,517
2006	4,868,221	4,938,420	875,351	4,063,069
2007	5,169,084	5,249,139	747,814	4,501,325

REINSURANCE

The Company had the following reinsurance agreements in force at December 31, 2007:

<u>Type of Agreement</u>	<u>Lines Covered</u>	<u>Net Retention</u>	<u>Reinsurer's Limits</u>
Property and Casualty Excess of Loss	Fire, inland marine and multiple lines (to include the casualty business of these lines)	<u>Property</u> \$20,000 ultimate net loss, each and every risk	\$980,000 ultimate net loss, each and every risk, each and every loss, subject to an occurrence limitation of \$1,960,000
		<u>Casualty</u> \$20,000 ultimate net loss, each and every risk	\$980,000 ultimate net loss, each and every insured, each and every loss
		<u>Combination</u> \$20,000 each and every loss occurrence	\$20,000 each and every loss occurrence
Property and Casualty Aggregate Excess of Loss	Fire, inland marine and multiple lines (to include the casualty business of these lines)		220% of the amount, if any, by which the Company's aggregate net losses exceed 90% of net earned premium income; not to exceed 220% of 95% of net earned premium income

All reinsurance is placed through Axiom Re, Inc., a reinsurance intermediary. All agreements contain an insolvency clause and a guarantee of the intermediary's credit.

SCOPE

This is a full scope financial condition examination initiated and conducted under the provisions of Article 4, Chapter 13 of Title 38.2 of the Code of Virginia. The examination covers the period from January 1, 2005 through December 31, 2007. Assets were verified and liabilities were established at December 31, 2007. A review of income and disbursements for the period was made to the extent deemed necessary.

The items comprising the Balance Sheet had a medium or low risk assessment as determined from the National Association of Insurance Commissioners *Examiners' Handbook*. Analytical review procedures were applied to non-SRA items.

In addition, the following matters were reviewed, several of which are discussed separately under their respective captions in this report.

- History
- Company Records
- Management and Control
- Fidelity Bond and Other Insurance
- Conflict of Interest
- Territory and Plan of Operation
- Growth of the Company
- Reinsurance
- Financial Statements

FINANCIAL STATEMENTS

There follows a statement of income and disbursements for the years 2005, 2006 and 2007, and a statement of financial condition at December 31, 2007.

INCOME FOR THE PERIOD UNDER REVIEW

	<u>2005</u>	<u>2006</u>	<u>2007</u>
Net assessments received	\$999,368	\$963,642	\$1,014,428
Interest on bonds	17,667	22,454	19,567
Interest on cash deposits	97,741	145,570	188,419
Dividends on stocks	994	53,668	118
Real estate	37,063	31,850	36,340
Gain on sale of investments	28		
Other income	<u>2,978</u>	<u>197,109</u>	<u>3,464</u>
Total Income	\$1,155,839	\$1,414,293	\$1,262,336
Deduct total disbursements for the year	<u>894,704</u>	<u>867,429</u>	<u>961,473</u>
Net Income	\$261,135	\$546,864	\$300,863
Add Ledger Assets December 31, previous year	<u>4,060,222</u>	<u>4,321,357</u>	<u>4,868,221</u>
Ledger Assets December 31, current year	<u><u>\$4,321,357</u></u>	<u><u>\$4,868,221</u></u>	<u><u>\$5,169,084</u></u>

DISBURSEMENTS FOR THE PERIOD UNDER REVIEW

	<u>2005</u>	<u>2006</u>	<u>2007</u>
Net losses paid	\$393,922	\$380,563	\$282,890
Loss adjustment expense	20,549	13,782	2,638
Commission and brokerage	115,286	121,490	146,593
Gross salaries	96,130	107,072	121,707
Directors' fees	27,700	28,518	29,667
Travel and travel items	1,874	2,150	2,436
Boards, bureaus and associations	4,705	4,740	4,927
Legal and auditing	15,333	17,209	13,188
Furniture, fixtures and equipment	5,704	6,363	8,230
Rent, office and equipment maintenance		5,195	10,322
Advertising	3,148	2,841	3,114
Printing and stationery	12,363	15,115	13,179
Insurance and fidelity bonds	17,256	17,541	17,729
Charitable contributions	525	540	200
Utilities	9,388	8,749	8,156
Other general expenses	6,391	8,823	6,071
Taxes, licenses and fees	13,267	14,980	15,081
Payroll items	25,565	30,761	37,166
Federal corporate income tax	110,179	67,151	226,489
Real estate	14,667	13,846	11,690
Virginia guaranty assessment	752		
Total disbursements	<u>\$894,704</u>	<u>\$867,429</u>	<u>\$961,473</u>

ASSETS

	Ledger Assets	Non- Ledger Assets	Assets Not Admitted	Net Admitted Assets
Bonds	\$436,220			\$436,220
Stocks	171,337	88,814		260,151
Cash in company's office	2,809			2,809
Cash on deposit	4,456,239			4,456,239
Real estate	53,153			53,153
Interest due and accrued				
On bonds		10,919		10,919
On cash deposits		7,555		7,555
Assessments due	22,093			22,093
Equipment, furniture, and supplies	27,233		27,233	
Totals	<u>\$5,169,084</u>	<u>\$107,288</u>	<u>\$27,233</u>	<u>\$5,249,139</u>

LIABILITIES, SURPLUS AND OTHER FUNDS

Net unpaid losses	\$385
Payroll items due or accrued	2,921
Other expenses due or accrued	3,411
Taxes, licenses and fees	15,028
Ceded reinsurance balances payable	76,636
Assessments unearned	499,949
Federal corporate income tax	116,647
Deferred income tax payable	<u>32,837</u>
Total liabilities	\$747,814
Excess of admitted assets over liabilities (surplus)	<u>4,501,325</u>
Totals	<u>\$5,249,139</u>

RECOMMENDATIONS FOR CORRECTIVE ACTION

Accounts and Records

1. During the review of the Company's bond investments, the Examiners noted that the Company receives investment management services from its custodian bank. The custodian determines which bonds to buy for the Company's investment account based on the investment guidelines provided by the Company. However, the current custodial agreement between the Company and the custodian does not account for investment management services. The Examiners recommend the Company either revise their current custodial agreement to include its investment management services or execute a separate agreement for these services.
2. A review of the Company's Schedule D in the filed Annual Statements revealed the following exceptions:
 - a. On Schedule D, Part 2, Column 8, the rate per share used to obtain the market value for all stocks was not reported correctly. A percentage of the market value to the actual cost of the stock was utilized rather than the rate per share. The market value however was reported correctly. This is the third consecutive examination in which this recommendation appears.
 - b. On Schedule D, Part 2, the Company reported an investment in the First Virginia Bank Short-Term Investment Pool. A review of the Company's investments revealed that the amount reported was actually invested in a different mutual fund. The market value of the investments was properly reported. The Company should take steps to properly identify its investments in future filings with the Bureau.
3. During the Examiners' review of cash receipts, it was noted that payments are not posted into the database system using the correct receipt date. The date entered into the database system is the date the system is updated; not the date the payment was received. According to the Company's procedures, cash payments are entered into the system twice a week; check payments are entered into the system once a week. Therefore, the payment date listed on the system is incorrect. The Examiners recommend the Company enter into their database system the correct receipt date for each payment received. This is the second consecutive examination in which this recommendation appears.
4. The Examiners' review of the Company's claim files revealed that the files were lacking important information such as dates and updates to claims status. In a number of instances, the Examiners were unable to determine whether the claims

remained open, were closed or had been denied. In addition, it is the Company's policy to maintain a claims log where all claims are listed in the order in which they are reported. However, it appeared that several of the claims selected for review were not recorded in the claims log. The discrepancies noted by the Examiners did not have a material effect on loss reserves at year-end. The Examiners recommend the Company maintain complete and accurate claim files and ensure that all claims are included in the claims log.

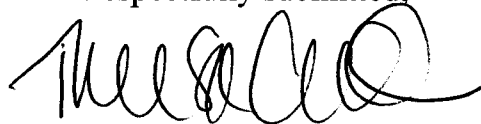
5. During the review of the asset, Assessments Due, the Examiners noted that the Company's receivable listing included not only aged amounts, but also policies that had been canceled and had not been removed from the listing in a timely manner. The amount of the difference was not considered material. The Examiners recommend that the Company immediately obtain or develop a system that will include all policies in such system, age each premium receivable, remove canceled policies in a timely manner, and properly account for premiums received for each policy. It is further recommended that the Company report only current receivables as admitted assets in future filings with the Bureau. This is the third consecutive examination in which this recommendation appears.

CONCLUSION

The courteous cooperation extended by the Company's officers and employees during the examination is gratefully acknowledged.

In addition to the undersigned, Mario A. Cuellar, CFE, Jennifer K. Crawley, CFE and T. Bradford Earley, Jr, CFE of the Bureau participated in the examination.

Respectfully submitted,

A handwritten signature in black ink, appearing to read 'Theresa C. Lewis', with a large, stylized loop at the end.

Theresa C. Lewis, CFE
Senior Insurance Examiner

FARMERS MUTUAL FIRE INSURANCE COMPANY
OF
WASHINGTON COUNTY, VIRGINIA
P. O. Box 827
Abingdon, Virginia 24212
Telephone - 628-2351

STATE LIFE INSURANCE COMMISSION
BUREAU OF INSURANCE
28 JUL 29 AM 9:12

August 24, 2008

David H. Smith, CFE, CPA, CPCU
Chief Examiner
STATE CORPORATION COMMISSION
Bureau of Insurance
Box 1157
Richmond, Virginia 23218

Re: Comments on Report of Examination

Dear Mr. Smith,

The referenced report has been reviewed and in regard to your recommendations for corrective action - please note:

Accounts and Records

Item #1 We agree that the Company received investment management services from its custodian bank and the present agreement does not account for investment management services. We are planning to execute a separate agreement for these services this will be done at our next Board meeting.

Item #2 Schedule D

(a) We agree that the rate per share used to obtain the market value was not reported correctly, we have again pointed this out to our Auditors and they have assured me that this will be corrected for future filings.

(b) We agree that an investment in the First Virginia Bank was not properly reported. We will be sure that the investments will be properly reported for future filings with the Bureau of Insurance.

Item #3 We agree that our cash receipts are not posted at the time the payment is received, we are in the process of updating our computer system and this is to be implemented within the next two weeks, this has been one of the things we asked to be on our system, but we are just now getting our one year policies on the system and this has to be up and going before we can post the payments to these accounts. It is my understanding that when the payments are received it

will be posted at that time to the accounts, so this problem should be solved.

Item #4 We agree that our claim files were lacking some information, we are updating our claims log and are listing all this information up front, and working closely with the adjuster to keep track of the claims that he is working on to determine if they are to be denied or still pending. This information will be correct for next years filing.

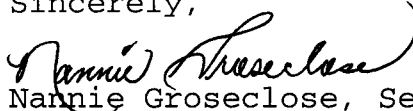
Item #5 We agree that the Company's receivable listing was not accurate, this has been a problem with our old computer system that has not been fully corrected on the new one. Our computer expert assures us that as soon as we get our one year policies on the system and the posting of payments as they are received that this problem will be taken care of. He assures us that this will not be a problem at this years ending.

We will try to the best of our ability to make sure that all the interrogatories, schedules and statements are completed correctly in future filings.

We will need ten (10) copies of the report, one for each of our directors and one for the office.

We appreciate the courteous cooperation shown to us by your examiners, Theresa C. Lewis, Mario A. Cuellar and Jennifer K. Crawley, they were very helpful and pleasant to work with.

Sincerely,



Nannie Groseclose, Sec.,Treas.
FARMERS MUTUAL FIRE INSURANCE CO.